

CHILE'S CRITICAL JUNCTURE

Slowdowns in exports and rising costs have forced the Chilean industry to decide whether to stay struggling at the entry level or raise the average price of its product mix and go head-to-head with more prestigious wines, says Eduardo Brethauer and Jürgen Mathäb.

The good old days for the Chilean wine industry, when its wines were coveted across the world, are a memory. Gone are the 1990s, when Chile's varietals, led by Cabernet Sauvignon, dominated entry-level segments with an enviable price to quality relationship. However, Chile has not conquered the world and, despite its best efforts, has not been able to position itself in segments with higher margins.

One of the greatest problems facing Chile is the strength of its currency. The rise of the Chilean peso relative to the US dollar, the major currency for most contracts, has eroded more than 30% of profits for a sector that had already begun to weaken. The reaction of the economic authorities has been timid, in spite of calls from Chilean winemakers to intervene against the dollar, since over three quarters of the country's wine is exported. Although the Central Bank, an independent government entity that oversees monetary policy, has begun buying dollars in recent months, it has not succeeded in turning around the fragile state of the wine industry.

According to Aurelio Montes, winemaker and owner of Viña Montes, the situation has improved a little, but it is still difficult for wine struggling to survive with the dollar trading at around 490 pesos. "If some kind of minimum price cannot be maintained, there will inevitably be widespread losses where companies would be forced to close their doors," he says. "With our current levels of income, we're not in a position to innovate."

In this sense, experts believe that Chile could replicate a phenomenon similar to the one experienced in Australia, where a handful of companies control almost 90% of total wine sales. However, Chilean wineries are biding their time, hoping that the situation changes and that several diversification plans and an increase in levels of quality will begin to bear fruit.

Low domestic consumption

Unlike other producer countries, such as France, Germany or Argentina, Chile's domestic market is insignificant. "Wine consumption in Chile has struggled to rebound in the wake of the so called wine export boom during the nineties," says Claudio Vallejo, manager of Intelvid, a wine consultancy.

During that decade, he explains, annual per person consumption climbed back to 26 litres, following the great collapse brought on by the economic recession of the early 1980s. But these figures are still small compared to the 1950s, when consumption was more than 58 litres per head; following the passage of the single shift labour law in the 1970s, consumption fell to 40 litres per head. Today domestic consumption is basically flat - and fell to just 14.5 litres in 2006.

According to Sebastián Ruiz, winemaker at Misiones de Rengo, beer has won the battle against wine, which now only represents 8% of the market. "The scene is complicated because you have to 'take a hit' to get into the supermarkets," he says, explaining that it takes concessions to get a foothold in stores, including promotions that directly benefit the consumer's pocketbook to the detriment of brand image and company profit.

The low exchange rate has had a harmful effect on bottom lines, yet has prompted winemakers to refocus on the domestic market. In 2007, the rate of consumption finally reached nearly 18 litres, brightening the spirits of producers.

Production costs, meanwhile, have increased in recent years, particularly for energy and labour. If it is still a relatively inexpensive place to invest compared to Western Europe and the US, the economic success of recent

decades has raised the price of land, especially in areas such as Maipo, Colchagua or Casablanca. The French businessman Thierry Villard, who sold his farm and bodega in Casablanca to Laroche in order to focus his efforts on a small-scale family project, believes that the fall in the exchange rate has weakened the competitiveness of Chilean wine. "In Entre-Deux-Mers [Bordeaux, France], for example, a hectare in full production costs €10,000. In Casablanca, on the other hand, which is unreachable from the highway, you cannot find anything for less than €25,000," he explains.

This difficult situation, exacerbated by worldwide over-production, has abruptly halted the explosive growth in surface area planted during the 1990s. According to Intelvid, there were barely more than 56,000 hectares cultivated in 1996. By 2001, that figure had nearly doubled, reaching 106,000. Growth

1	Benchmark Data	www.cl
	Population:	16.6m
	GDP (PPP):	\$231bn
	Currency:	Peso (1000 CLP = €1.32)
	Per head wine consumption:	18 litres
	Area under production:	118,000 hectares
	Total production:	828m litres
	Export:	74.6%



continues today, albeit at much more modest rates, with 116,000 hectares in production last year. Ongoing growth is driven primarily by projects in valleys where wine has not been produced in the past, such as San Antonio, Limarí and Bío Bío.

Cabernet Sauvignon versus the rest

Although Carmenère has proven its ability to attain high levels of quality, especially in higher price blends, Cabernet Sauvignon still reigns supreme across the Chilean countryside, accounting for almost one-fourth of the value of total exports. Of the more than \$1.2bn exported during 2007, Cabernet Sauvignon sold more than \$300m, which is more than double the sales of Sauvignon Blanc, at \$137m.

"Cabernet Sauvignon is very much consolidated in Chile. If you mention Chile to anyone in the world, Cabernet Sauvignon comes to mind. But we need to diversify and expand our offering of varieties," says Marco Puyó, San Pedro's chief winemaker. "Different ideas must emerge to make us more appealing from a commercial standpoint."

During the magical period of the late 1990s, what had been a nearly defunct variety, Carmenère, opened a new chapter for Chilean wines. But while the wine offers potential, its relationship with viticulturalists has yet to mature, generating emotions that range from distrust to jubilation. "I foresee a good future for the variety," says Andrés Ilabaca, winemaker for Santa Rita. As to whether it will become Chile's iconic variety, he says that will take time. "A variety becomes iconic when it demonstrates consistent quality at all levels with characteristics that evoke its origin and always turn out well. So far in Chile, that has not happened with Carmenère."

According to Francisco Baettig, chief winemaker for Errázuriz, it is indeed possible to attain a standard of quality at all price points. "Production must be lowered and we have to be patient. Carmenère is not like Shiraz, which produces good wine with young plants. It needs older plants to yield quality." He also argues that the industry needs to display some will power. "If it grows at a rate of 25% to 30%, and with the dollar worth less than 500 Chilean pesos, it is difficult to lower output in order to produce better wines."

Ignacio Recabarren, winemaker for Concha y Toro, is in love with the wine and is one of its main supporters. "If Carmenère were Australian, it would have been a global star thirty years ago," he says.

Signature varieties

Mario Geisse, technical director of Casa Silva, says that while winemakers raise the flag of Carmenère, people should not assume that it is the only top-quality wine produced in Chile. "We must demonstrate how fortunate we are to have the conditions and diversity of soil and climate in our country," he says.

Andrés Ilabaca wonders: "Wouldn't it be better to have a signature variety for each valley, just as Cabernet Sauvignon has been consecrated in the Maipo Valley? I even think that taking this path would project a more mature image for the

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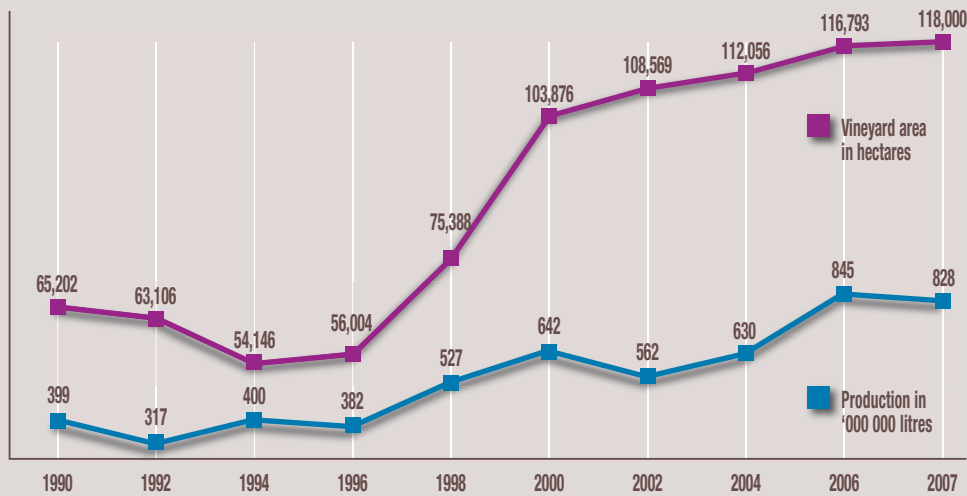


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REGIONAL ANALYSIS

2 Snapshot of Chile



Although the price of vineyard land in Chile looks to be good value when compared to the cost of land in Western Europe or California, land prices in sought-after areas such as Maipo and Casablanca have been driven upwards in recent years. The fall in the exchange rate means that vineyard land is less of a bargain when looked at closely: as Thierry Villard points out, a hectare of land in Entre-Deux-Mers in full production is less than half the price of a hectare of land in Casablanca, where there is far less infrastructure to support it. That should be something for international investors to consider.

3 Bottled wine exports by country

Country	January to December 2006			January to December 2007			Change in %		
	Cases	US\$ FOB	\$ per case	Cases	US\$ FOB	\$ per case	Cases	US\$ FOB	\$ per case
UK	6,976,900	146,216,694	20.96	8,976,908	212,029,333	23.62	28.7	45.0	12.7
USA	5,824,891	148,294,669	25.46	6,638,168	183,902,117	27.70	14.0	24.0	8.8
Canada	1,389,135	48,316,060	34.78	1,603,965	59,945,176	37.37	15.5	24.1	7.4
Germany	1,409,158	37,108,429	26.33	1,921,008	51,349,528	26.73	36.3	38.4	1.5
Brazil	1,588,110	36,830,224	23.19	2,082,713	50,390,753	24.19	31.1	36.8	4.3
Netherlands	1,467,815	38,601,287	26.30	1,838,397	49,893,184	27.14	25.2	29.3	3.2
Ireland	1,312,300	38,779,296	29.55	1,341,879	43,748,155	32.60	2.3	12.8	10.3
Denmark	1,148,586	35,273,538	30.71	1,264,097	41,199,012	32.59	10.1	16.8	6.1
Japan	866,263	24,775,093	28.60	1,205,015	32,899,070	27.30	39.1	32.8	-4.5
Belgium	787,036	23,568,597	29.95	870,402	27,341,306	31.41	10.6	16.0	4.9
Others	2,125,755	55,964,192	84.15	2,891,343	80,529,339	88.22	147.2	170.3	11.6
Total	31,940,004	824,982,407	25.83	39,230,928	1,080,941,364	27.55	22.8	31.0	6.7

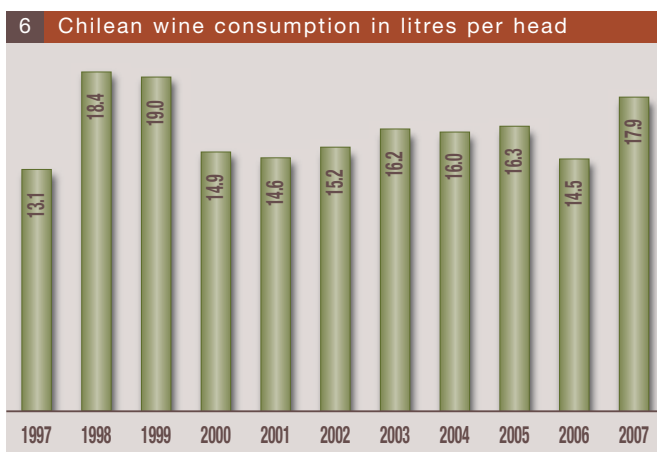
The UK and the US received 33% of Chile's exports in 2007.

4 Bottled wine exports by producer

Producer	January to December 2006			January to December 2007			Change in %		
	Cases	US\$ FOB	\$ per case	Cases	US\$ FOB	\$ per case	Cases	US\$ FOB	\$ per case
Viña Concha y Toro	7,697,986	175,616,628	22.81	9,830,668	239,291,452	24.34	27.7	36.3	6.7
Viña Cono Sur	1,958,949	40,015,398	20.43	2,514,070	57,160,604	22.74	28.3	42.8	11.3
Viña San Pedro	2,287,070	44,945,943	19.65	2,571,390	56,674,475	22.04	12.4	26.1	12.2
Viña Santa Rita	1,110,975	40,169,919	36.16	1,277,569	50,243,545	39.33	15.0	25.1	8.8
Viña Montes	479,285	25,333,527	52.86	682,917	37,657,444	55.14	42.5	48.6	4.3
Viña Sta. Carolina	1,063,542	23,694,532	22.28	1,237,892	29,832,553	24.10	16.4	25.9	8.2
Viña Errázuriz S.A.	468,483	21,371,134	45.62	547,040	28,559,886	52.21	16.8	33.6	14.4
Viña Tarapaca ex Zavala	688,678	19,499,724	28.31	827,521	24,534,804	29.65	20.2	25.8	4.7
Viña Ventisquero Ltda	621,359	16,070,866	25.86	877,409	23,727,035	27.04	41.2	47.6	4.6
Viña Undurraga	782,296	20,570,537	26.30	793,792	22,158,004	27.91	1.5	7.7	6.1

In terms of volume, Chile's branded wines have made their mark. But a major challenge is to raise the average price per bottle. According to Intelvid, the average price in 2007 was just \$2.07 per litre.

5 Varietal Breakdown 2007 (total area 116,793 ha)			
Red grapes (75.6%)	Area in ha	White grapes (24.4%)	Area in ha
Cabernet Sauvignon	40,789	Sauvignon Blanc	8,697
Pais	14,957	Chardonnay	8,548
Merlot	13,368	Muscat Alexandria	6,029
Carmenere	7,183	Semillon	1,727
Syrah	3,370	Torontel	1,039
Tintoreras	2,905	White total	28,467
Pinot Noir	1,382	While Cabernet Sauvignon continues to reign supreme, there are suggestions that Chile needs to diversify its offerings. Sauvignon Blanc is one wine that does particularly well, and Pinot Noir is another, though in the case of the latter, it is too expensive to grow to allow for explosive growth.	
Cabernet Franc	1,143		
Malbec	1,027		
Red total	88,325		
Combined total	116,793		



In the 1950s Chilean consumption peaked at 58 litres per head. Well into the 1970s it was still over 40.

7 Total evolution in 10 major export destinations*						
Country	2007			Change in %		
	US\$ ¹	litres ²	\$ per litre	US\$	litres	\$/L
UK	230,174	101,578	2.27	50.34	29.02	16.53
USA	185,590	61,153	3.03	25.84	8.98	15.47
Germany	70,895	59,089	1.20	9.90	26.88	-13.38
Canada	68,281	29,929	2.28	27.97	14.14	12.11
Denmark	55,614	28,609	1.94	11.40	-2.52	14.29
Netherlands	53,934	22,399	2.41	48.13	48.35	-0.15
Brazil	50,879	18,896	2.69	82.59	62.45	12.40
Ireland	43,890	12,183	3.60	17.27	3.76	13.02
Japan	40,834	17,827	2.29	39.62	33.11	4.89
China	40,196	70,568	0.57	341.38	964.00	-58.52
Rest	416,359	189,078	2.20	51.73	50.50	0.82
Total	1,256,645	611,309	2.06	42.34	45.16	-1.94

* for Chilean wine including bulk; ¹ in '000 US\$; ² in '000 litres

“Carmenère, Syrah and Pinot Noir have helped the Chilean industry to position top quality wines internationally at higher price levels.”



Claudio Vallejo, general manager of Intelvid

industry, and likewise a more complex and exciting image for the country.”

A decade ago, no one in Chile would have imagined that the number two selling wine would be a white, but Sauvignon Blanc has earned a privileged position in a country of red wines, thanks to its quality and profitability. According to Chilean producers, in the coldest valleys such as Casablanca, San Antonio or the Limarí coast, it is possible to produce very good Sauvignon Blancs, which are fruity, sharp and deep, at very good yields per acre.

But Sauvignon Blanc isn't the only rising star. “Shipments of bottled wine, including Carmenère, Syrah and Pinot Noir, which were added to statistical measures in 2007, demonstrate the high level of participation of these varieties among overall national wine exports,” says Claudio Vallejo of Intelvid. “As a result, overall growth generally has exhibited an upward trend, though this has been driven primarily by the national wine industry's development in terms of positioning top quality wines abroad at price levels that continue to rise.”

Chilean Pinot Noir reached the highest value in 2007, its average price more than double the overall average of Chilean wines, reaching \$4.53 per litre. Although a growth in planted surface area is expected in upcoming years, it will not match the explosive growth of other wines during the past decade. Currently there are only 1,400 hectares planted, and according to Thierry Villard, producers will think twice before planting more due to the high cost per acre that they face. “The management of a vineyard costs about \$6,000 per acre,” he says, arguing that Sauvignon Blanc is less problematic. “Your management costs are much lower, and you're not going to be paid less than \$1 per kilogram. You can easily produce 15 tonnes per hectare. It's a no brainer.”

One of the biggest headaches for Chilean wine industry has been to get beyond its image as a producer of ‘good, pretty and cheap’ wines. The image-shifting strategy of Wines of Chile, the body responsible for the promotion of Chilean wines abroad, has yielded conflicting results. Though exports have grown in recent year at double digit rates, crossing the psychological barrier of \$1bn, the industry's main challenge remains raising the average price per bottle. According to Intelvid, the average 2007 price was just \$2.07 per litre.

Primary markets

The UK remains the major market, with sales of more than \$200m, followed by the US with \$185m and

INTERVIEW WITH JUAN SOMAVÍA

After a stint as the head of the European Economic Affairs Department in Chile's Ministry of Foreign Affairs, Juan Somavia spent five years in New York as the foreign trade officer for ProChile. At that time, he was an active member of the team that successfully negotiated the Trade Agreement between Chile and the European Union. In February 2008 he replaced Ricardo Letelier as the managing director of Wines of Chile, the generic office in charge of the international promotion of Chilean wines in Santiago. We spoke to him about his plans.

Meininger's: Where do you see your priorities at Wines of Chile?

Somavia: We must make Chile more attractive as a country. Our image in the consumer's mind is more important than any individual programme that we might run.

Meininger's: Isn't this tough, with Chile's reputation anchored to value for money?

Somavia: Of course, but one of our principal goals will be to increase the average price of our bottled exports and with that Chile's global wine profile. Currently, we have more or less the same problem everywhere. We are seen if not as cheap, at best as good value. Our quality image tends to be only a secondary consideration.

Meininger's: How can you change that?

Somavia: One of the things that we want to do is focus on our

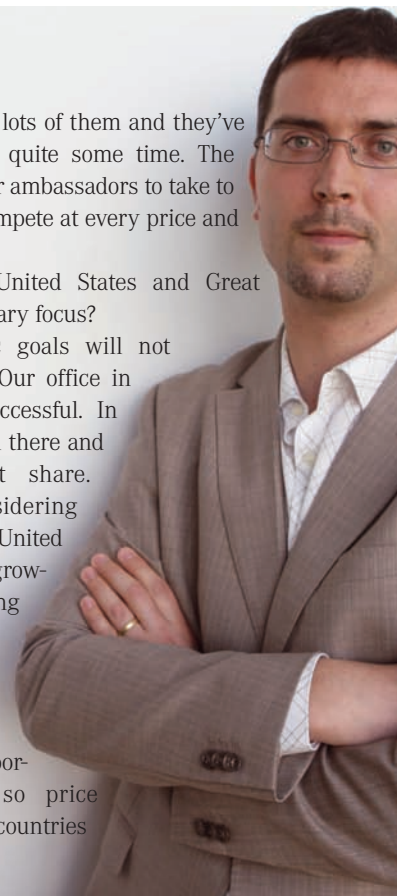
upscale wines. There are lots of them and they've been on the market for quite some time. The message that we want our ambassadors to take to heart is that Chile can compete at every price and quality point.

Meininger's: Will the United States and Great Britain remain your primary focus?

Somavia: Our strategic goals will not change in that respect. Our office in London is extremely successful. In 2007 we surpassed Spain there and now have 8% market share. Currently we are considering opening an office in the United States. Although we are growing there, we are losing market share.

Meininger's: What about markets like Germany that buy a lot of bulk?

Somavia: Germany is important in volume, but so price conscious, we see other countries offering better potential.



Germany with \$70m. If these rankings hold, concern is generated by low average prices per litre, primarily in the fragmented German market, where Chilean wine barely tops \$1 per litre.

According to Intelvid, the greatest increase, both in terms of value and volume, was generated last year through exports to China, up a staggering 341% in value and 964% in volume. "However, the United Kingdom and the United States are undoubtedly the two biggest markets, representing 33% of total exports in 2007," says Vallejo. "In terms of comparison by continent, Europe absorbed 36% of our exports last year, followed by North America with 21%."

One of the strategies of Chilean wines to make up for slow growth among traditional destinations has been to open new markets, especially in Asian countries. Although China has delivered the greatest growth in percentage terms, it remains a nascent market geared towards bulk demand. According to Sven Bruchfeld, Santa Carolina's chief winemaker, South Korea and Malaysia are more compelling markets in which Chile has been very strong and where margins are much more promising. However, it is important to remain plugged into China, because "when the giant awakes, you need to be by his side".

First quarter 2008

According to Wines of Chile, total exports of wine in the first quarter of 2008 reached 145m litres, to a value of \$300m.

Though these figures represent an increase of 11.3% in value and 1.9% in volume compared to the same period a year ago, this indicates a reduction in the growth rate. "In spite of the continuation of positive results, they represent a wakeup call to change course," says René Merino, president of Wines of Chile. He says the export slowdown, reflected in slower growth rates, points to the need to step up international promotion that would facilitate sales of products with greater value added and compensation for the profitability decline. "These reasons, on top of the lower value of the US dollar and the higher costs of inputs and labour, put the industry in a decidedly unfavourable position, which requires public-private initiatives to increase sales abroad."

Perhaps as never before, Chile is at a critical juncture today. Its wine sector not only wants to be recognised as a provider of mid-market wines, but also as a burgeoning industry with great diversity and potential for quality. In addition to spurring experimentation with an increasingly rich selection of vines, new investments in valleys with more extreme climatic conditions, including coastal, mountain or Austral [southern Chile] vineyards, promise to change the nature of Chilean wine offerings. Winemakers may speak of their unique terroir, allowing vines to reach their highest potential, but such efforts will be in vain if the boost to Chilean viticulture quality is not supported and promoted on a broad scale. Meanwhile, the Chilean landscape is complicated. Chile finds itself at the breaking point, but is ready to demonstrate that it can be a worthy competitor in all price categories. ■



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